UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

STATE OF NEW YORK, STATE OF CONNECTICUT, STATE OF MARYLAND, and STATE OF NEW JERSEY,

Plaintiffs,

v.

STEVEN T. MNUCHIN, in his official capacity as Secretary of the United States Department of Treasury; the UNITED STATES DEPARTMENT OF TREASURY; CHARLES P. RETTIG, in his official capacity as Commissioner of the United States Internal Revenue Service; the UNITED STATES INTERNAL REVENUE SERVICE; and the UNITED STATES OF AMERICA,

Defendants.

18 Civ. 6427 (JPO)

# REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THE GOVERNMENT'S MOTION TO DISMISS AND IN OPPOSITION TO THE STATES' CROSS-MOTION FOR SUMMARY JUDGMENT

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## PRELIMINARY STATEMENT

Defendants Steven T. Mnuchin, in his official capacity as the Secretary of the Treasury; the United States Department of the Treasury; Charles P. Rettig, in his official capacity as Commissioner of Internal Revenue; the Internal Revenue Service; and the United States of America, by their attorney, Geoffrey S. Berman, United States Attorney for the Southern District of New York (together, the "Government"), respectfully submit this reply memorandum of law in further support of their motion to dismiss the complaint filed by the States of New York, Connecticut, Maryland, and New Jersey, ECF No. 43 ("U.S. Br."), and in opposition to the States' cross-motion for summary judgment, ECF No. 45 ("States Br.").[1] For the reasons explained herein and in the Government's opening brief, the States' complaint should be dismissed and their motion for summary judgment should be denied.

## ARGUMENT[2]

### I. The States' Complaint Should Be Dismissed Under Rule 12(b)(1)

As explained in the Government's opening brief, the States' complaint should be dismissed under Federal Rule of Civil Procedure 12(b)(1), because the States lack standing, the

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[1] This brief uses abbreviations and capitalized terms defined in the Government's opening brief. It cites the States' Local Rule 56.1 Statement, ECF No. 46, as "States 56.1," and documents attached to the Declaration of Owen T. Conroy, ECF No. 47, as "Conroy Decl. Ex. [number]." The documents cited in the Government's opening brief and herein are reproduced in the Conroy Declaration and/or available at the cited websites. The Government will provide copies to the Court upon request.

[2] The Government does not concede the accuracy or materiality of the statements set forth in the States' brief as "undisputed facts," *see* States Br. at 2-4, as explained in more detail in the Government's accompanying response to the States' Local Civil Rule 56.1 statement. Many of the statements that the States present therein are not material to the relevant constitutional analysis or are unsupported by admissible evidence, among other issues.

Anti-Injunction Act bars their claims, and their complaint is non-justiciable. *See* U.S. Br. at 8-18. The States' opposition does not overcome these deficiencies.

### A. The States Lack Standing to Bring This Suit

First, as explained previously, *see* U.S. Br. at 9-14, the States lack standing to challenge the SALT deduction cap in the 2017 Tax Act because they fail to allege a sufficiently concrete, particularized, and imminent injury flowing from the cap's enactment. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). The States reference the "special solicitude" the Supreme Court afforded the state in *Massachusetts v. EPA*, 549 U.S. 497 (2007),[3] *see* States Br. at 6, but any such solicitude "does not relieve a State plaintiff from its obligation to establish a concrete injury," *Vullo v. Office of Comptroller of the Currency*, No. 17 Civ. 3574 (NRB), 2017 WL 6512245, at *7 (S.D.N.Y. Dec. 12, 2017) (citing *Del. Dep't of Nat. Res. & Envtl. Control v. FERC*, 558 F.3d 575, 579 n.6 (D.C. Cir. 2009)). Indeed, the standing inquiry is "especially rigorous when reaching the merits of the dispute would force [a court] to decide whether an action taken by one of the other two branches of the Federal Government was unconstitutional." *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 408 (2013) (quotation marks and citation omitted).

The States claim that they have "three independent categories of sovereign or quasi-sovereign interests that suffer concrete harm and thus establish standing" in this case.[4] States Br.

[3] The facts of *Massachusetts v. EPA* are far afield from this case. In *Massachusetts*, the Court relied in its standing analysis on: (1) the fact that Congress had accorded a specific procedural right to protect the state's interest by challenging the agency action at issue, and (2) Massachusetts's direct and concrete interest in protecting its territory from harmful emissions. 549 U.S. at 518-20. There is no similar procedural right here, nor any nearly comparable asserted sovereign or quasi-sovereign injury. As discussed below, the States' own description of their purported injury shows that it is highly attenuated, indirect, and speculative. *See infra* footnote 5.

[4] The States do not assert proprietary standing, which has been the primary basis of state standing in a number of recent cases, *see, e.g.*, *Hawai'i v. Trump*, 241 F. Supp. 3d 1119, 1129

at 6. In fact, none of their asserted harms establishes an injury sufficient for standing. First, the States claim that "[t]he new [SALT] cap puts pressure" on them by requiring them to make a "forced choice" "between their current level of public investments and higher tax rates." *Id.*[5] But this supposed "choice"—in reality, a policy question about how to set state-level priorities in light of federal ones—bears no resemblance to the cases the States cite, in which courts found that state plaintiffs were legally harmed by having to elect between two impermissible options. For example, in *New Mexico v. Department of Interior*, 854 F.3d 1207, 1218 (10th Cir. 2017), *cited in* States Br. at 6 n.4, a state challenged the legitimacy of a federal regulatory process, and the court held that the state had standing because it would have to "choose between participating in a process it considers unlawful and forgoing any benefit from that allegedly unlawful process." *See also Thomas v. Union Carbide Agr. Prods. Co.*, 473 U.S. 568, 582 (1985) (recognizing "the injury of being forced to choose between" participating in an unlawful agency adjudication or forfeiting the right to participate). The States are not being forced into any

(D. Haw. 2017), and claim to disavow *parens patriae* standing, in which a state litigates the personal claims of its citizens, *see* States Br. at 7 n.6 (disavowing *parens patriae* standing), which, in any event, is generally prohibited when states sue the federal government. *See* U.S. Br. at 10-11. They do, however, conflate their own sovereign interests with the personal interests of their residents throughout their brief, an elision the Court should reject. *See, e.g.*, *id.* at 22-23 (estimating the cost of the SALT deduction cap to the States' taxpayer residents in discussing the alleged harms that the Plaintiff States will face due to the cap).

[5] The "forced choice" injury asserted by the States is speculative, indirect, and highly attenuated. According to the States, the SALT deduction cap will make it more expensive for their residents to own homes, which "could" reduce homeowners' equity in their homes and their payment of real estate transfer taxes to the States upon sale. States Br. at 23. Such losses, in turn, "could" result in lost jobs, reducing the States' income- and sales-tax collections. *Id.* By reducing this tax revenue "and making state taxes more expensive," the SALT deduction cap supposedly would then "make it more difficult for the Plaintiff States to raise their own tax revenue." *Id.* at 24. This, finally, will purportedly impede their "ability to make public investments and maintain current levels of public services." *Id.* Despite the States' characterization of this five-step chain as "direct," *id.*, these alleged injuries cannot be fairly characterized as "certainly impending." *Clapper*, 568 U.S. at 401.

comparable choice here. They need not participate in any federal process, and they may choose to adjust their fiscal policies in any number of ways in light of the 2017 Tax Act, or not at all.

Moreover, the States do not explain the difference between this supposed injury and any other scenario in which a state contemplates taking some action in response to a change in federal law that affects its citizens. Without a "forced choice" injury to the States of the type recognized in *New Mexico v. Department of Interior* or *Thomas v. Union Carbide*, they may not simply manufacture one to evade the general prohibition against *parens patriae* suits by states against the federal government. *See supra* footnote 4; *see also Alfred L. Snapp & Son, Inc. v. Puerto Rico*, 458 U.S. 592, 610 n.16 (1982).

The States also rely on a single sentence in *Texas v. United States*, 787 F.3d 733 (5th Cir. 2015), discussing whether the state plaintiffs had standing to challenge a program offering certain immigrants temporary relief from deportation. *Id.* at 748, *cited in* States Br. at 6. The program required states to issue driver's licenses to the program's beneficiaries at the states' expense and in violation of state law. *Id.* While the states could choose to defray this cost by raising their license application fees, the Fifth Circuit noted that "being pressured to change state law" to recoup these costs "constitutes an injury." *Id.* at 749. The court's analysis did not rest primarily on such "pressure," however, but on the actual financial cost of issuing the licenses. *Id.* at 748. More importantly, the Fifth Circuit's subsequent opinion in the same case "stress[ed] that [its] decision is limited to these facts"; "the direct, substantial pressure directed at the states and the fact that they have surrendered some of their control over immigration to the federal government mean this case is sufficiently similar to *Massachusetts v. EPA*" to support standing, "but pressure to change state law may not be enough—by itself—in other situations." *Texas v. United States*, 809 F.3d 134, 154-55 (5th Cir. 2015).

There is no similar direct, proprietary financial injury to (or pressure on) the States here, nor any comparable surrender of control in a particular area of law. Rather, the alleged indirect "pressure" in this case is similar to the pressure that the Supreme Court rejected as a basis for state standing in *Florida v. Mellon*, 273 U.S. 12 (1927), in which the Court held that a change to federal tax law, which the state plaintiff characterized as "a direct effort on the part of Congress to coerce" it into changing its own tax laws, did not present a "tenable" ground "to invoke the jurisdiction" of the Court. *Id.* at 16; *see* U.S. Br. at 12.

The States have no answer to *Florida v. Mellon* other than to dismiss it as "old," and claim that its holding has been limited by *National Federation of Independent Business v. Sebelius*, 567 U.S. 519, 585 (2012) ("*NFIB*"), and other anti-commandeering cases. States Br. at 7-8. But *NFIB* (which did not address standing at all, *see NFIB*, 567 U.S. at 588) involved the federal government's imposition of a direct financial penalty on states for failing to participate in a federal program. Here, there are no conditions or penalties imposed on the States. *Compare id.* at 575-88. Nevertheless, the States invite the Court to expand and misapply *NFIB* to hold that the alleged indirect effect of a nationally applicable cap on SALT deductions somehow creates standing. The Court should reject this invitation. The States simply do not face the type of "forced choice" that courts have found to constitute a sovereign injury.

The States' second asserted injury is their supposed loss of "substantial tax revenue" as a result of the SALT cap. States Br. at 8-9. This purported harm also bears no resemblance to the cases on which the States rely. The States fail to identify any "loss of specific tax revenues" comparable to the precisely enumerated lost severance taxes at issue in *Wyoming v. Oklahoma*, 502 U.S. 437, 445, 448 (1992), *cited in* States Br. at 8 nn.7, 9. The States vaguely claim they will lose "specific *streams* of tax revenue in the form of lost sales taxes, real estate transfer taxes,

and certain property taxes," States Br. at 9 (emphasis added), but this is insufficiently particular. *See Wyoming v. Dep't of Interior*, 674 F.3d 1220, 1234 (10th Cir. 2012) (rejecting state's claim that it had standing because "a specific *source* of revenue, sales tax, is reduced" by challenged regulations) (emphasis added). Courts have recognized standing in this type of circumstance only where there is "a direct injury in the form of a loss of *specific* tax revenues." *Id.* (emphasis in the original); *see also, e.g.*, *Dist. of Columbia v. Trump*, 291 F. Supp. 3d 725, 739-40 (D. Md. 2018) ("[a] decline in general tax revenues is not enough" to show a direct injury for standing purposes). The States identify no such loss of specific tax revenue here. Moreover, the injury in *Wyoming v. Oklahoma* (the loss of tax revenue from sales of Wyoming coal due to an Oklahoma law decreasing that state's purchase of Wyoming coal) was far more direct than the indirect, attenuated injury that the States claim in this case, *see supra* footnote 5. The States' failure to identify a direct injury to specific tax revenues in this case raises the question of whether, under their theory, they would have standing to challenge *any* federal tax increase that generally reduced their citizens' spending power and, conceivably, their own tax revenues.

The States' third and final asserted injury is premised on their argument that "Congress expressly targeted" them "for unequal treatment" in enacting the SALT cap. States Br. at 9. This is indistinguishable from their "equal sovereignty" argument, which is addressed below, *see infra* Part II.C. The SALT deduction cap does not treat any states unequally. *Id.* Indeed, it does not regulate states at all. Instead, it applies to all similarly situated American taxpayers. The States' cited case is inapposite, as it concerned *parens patriae* and proprietary (rather than sovereign) standing. *See Ga. v. Pa. R.R. Co.*, 324 U.S. 439, 445 (1945). In addition, because the *Georgia* case involved antitrust claims by a state against private companies, it explicitly

"involved no question of distribution of powers between the State and the national government," distinguishing it from, for example, *Florida v. Mellon*. *Id.*

Thus, none of the States' asserted injuries is sufficient to establish their standing to challenge the SALT deduction cap.

**B. The Anti-Injunction Act Bars the States' Suit**

The States' next argument, that the AIA does not bar their complaint, rests entirely on a narrow exception to the statute recognized by the Supreme Court in *South Carolina v. Regan*, 465 U.S. 367 (1984). *See* States Br. at 10-12.[6] In *Regan*, the Court permitted South Carolina to challenge a federal tax law that limited the exemption for interest on state-issued bonds to exclude unregistered bearer bonds, because there was no reason why any individual taxpayer would have the incentive to challenge the law. *See* 465 U.S. at 380. As this could have meant that the challenged law would never be reviewed, the Supreme Court recognized a narrow exception to the AIA. *See id.* at 380-81. Subsequent decisions in the courts of appeals have confirmed that this exception is indeed narrow. *See Confederated Tribes & Bands of Yakama Indian Nation v. Alcohol & Tobacco Tax & Trade Bureau*, 843 F.3d 810, 815 (9th Cir. 2016); *RYO Machine, LLC v. Dep't of Treasury*, 696 F.3d 467, 472 (6th Cir. 2012); *Judicial Watch, Inc. v. Rossotti*, 317 F.3d 401, 408 n.3 (4th Cir. 2003).

The *Regan* holding does not apply in a case like this, where there is no mismatch between the party most affected by the law and the party with an incentive or ability to sue to challenge it.

[6] The States also suggest, incorrectly, that the AIA does not apply to states, *see* States Br. at 10 n.12, though the statute clearly does apply to states, *see* U.S. Br. at 14-15 (citing *Texas v. United States*, 300 F. Supp. 3d 810, 835 (N.D. Tex. 2018), and *Regan*, 465 U.S. at 373-81); *see also Confederated Tribes & Bands of Yakama Indian Nation v. Alcohol & Tobacco Tax & Trade Bureau*, 843 F.3d 810, 813 (9th Cir. 2016) (concluding that Indian tribes are "persons" for purposes of the AIA largely on the basis that "it is consistent with courts' treatment of other sovereign entities," including states, "as 'persons' for various provisions of the Internal Revenue Code").

The States allege that some taxpayers' federal tax liability will increase as a result of the 2017 Tax Act, *see, e.g.*, Compl. ¶¶ 90, but do not explain why such taxpayers are statutorily limited or otherwise disincentivized from challenging the Act. Without such a showing, the States cannot overcome the AIA. This case is thus like *Yakama Indian Nation*, 843 F.3d at 815, in which the Ninth Circuit concluded that the *Regan* exception to the AIA did not permit an Indian tribe to challenge a tobacco excise tax, as the affected taxpayers and tobacco companies had sufficient incentives to sue on their own account. *See also RYO Machine*, 696 F.3d at 472 (finding a "contrast" with *Regan* where there was "much more than a mere possibility" of taxpayer refund suits challenging the provision at issue); *cf. Texas v. United States*, 300 F. Supp. 3d 810, 836 (N.D. Tex. 2018) (concluding *Regan* exception applied where federal statute afforded only private party experiencing no economic harm the right to challenge regulation at issue, which imposed direct costs on the state). Here, taxpayers have a sufficient economic incentive to challenge the new cap on the SALT deduction, should they choose to do so, and the AIA bars the States' suit.

### C. The States' Complaint is Non-Justiciable

Finally, the States fail to show that their disagreement with Congress's tax policy choices is justiciable under any cognizable legal standard. *See* U.S. Br. at 17-18. The States attempt to redefine the scope and import of the relief they seek, claiming that the Court need not fashion a generally applicable test for assessing *any* imaginable SALT deduction limit in order to determine that this particular limit is unconstitutional. States Br. at 14. But this argument still raises the question of what type of analysis the Court should undertake to assess whether the current cap is constitutionally infirm. Because the States do not argue that *all* limitations on the

SALT deduction are necessarily unconstitutional, their position requires some legal test or standard to determine whether this particular limitation is improper.

If the States' quarrel is with the cap's dollar value, they must articulate a constitutionally based rule and explain why the Court should conclude that a $10,000 limit—but presumably not all possible limits—runs afoul of it. If the States fault the "direct" nature of the limitation, they must persuade the Court of the constitutional significance of dollar limitations on the deduction as opposed to other types of limits, such as those based on taxpayers' overall income or other deductions taken (*e.g.*, the alternative minimum tax ("AMT") or the Pease limitation), even when their effect is functionally similar and they have previously survived constitutional scrutiny. *See* U.S. Br. at 27. But the States have offered no neutral standards or criteria for the Court to apply, nor have they identified any constitutional provisions or doctrines that set forth such standards or criteria.

The States' identification of what they claim are "similar" cases in which courts have decided constitutional questions only demonstrates why this case is non-justiciable. *See* States Br. at 13. Each of the cited cases concerned a much starker question of whether a certain governmental act was constitutional: *South Carolina v. Baker*, 485 U.S. 505, 507-08 (1988), concerned whether Congress could tax interest income from state bonds; *NFIB*, 567 U.S. at 575-88, whether Congress could exercise its conditional spending power to make states' receipt of all federal Medicaid funds contingent on their participation in the expanded program; and *Shelby County v. Holder*, 570 U.S. 529, 534-36 (2013), whether the Government could continue to enforce provisions of the Voting Rights Act. Here, by contrast, the States do not contend that legislation that has the effect of limiting SALT deductions is *per se* unconstitutional (nor could they plausibly do so because many such provisions have been previously enacted, which they do

not challenge). Rather, they quibble with the dollar limit of the cap (while implicitly allowing that other dollar limits might pass muster), and with the fact that the cap accomplishes directly what had previously been achieved indirectly. This is an argument over granular legislative choices, not constitutional standards; it is classically political, and not suited for judicial intervention. *Cf. Gilligan v. Morgan*, 413 U.S. 1, 10 (1973) ("It would be difficult to think of a clearer example of the type of governmental action that was intended by the Constitution to be left to the political branches directly responsible—as the Judicial Branch is not—to the electoral process").

## II. The States' Complaint Fails to State a Claim, and the States Are Not Entitled to Summary Judgment

Even assuming jurisdiction, the States' complaint should be dismissed under Federal Rule of Civil Procedure 12(b)(6). The States have, in large part, disavowed their reliance on specific constitutional provisions (principally the Sixteenth Amendment), but argue nonetheless that ill-defined principles of federalism and state dignity require Congress to maintain a SALT deduction that is "substantial" enough to satisfy their policy preferences. *E.g.*, States Br. at 18. These arguments are meritless, and the States' claims should be dismissed. Nor are the States entitled to summary judgment pursuant to Federal Rule of Civil Procedure 56. The Government does not concede the accuracy or materiality of the assertions and characterizations on which the States rely in support of their motion, *see supra* footnote 2,[7] but even taking their assertions at face value, they do not establish that the SALT deduction cap is unconstitutional.

### A. Federalism Principles Do Not Require an Unlimited SALT Deduction

In contrast to their complaint, the States' motion papers abandon their contention that the Sixteenth Amendment is the basis for their principal constitutional claim, and now premise their

[7] The States do not argue that discovery is needed in this case. *See* States Br. at 2-3.

claim on unwritten federalism principles. *Compare* States Br. at 17-18 ("[T]he Plaintiff States are not arguing that the Sixteenth Amendment itself established the constitutional significance of the SALT deduction. Rather, the source of the constitutional claim here is the States' original and sovereign 'power of taxation,' which predates the Founding and was incorporated into our constitutional structure."), *with* Compl. ¶ 133 ("In imposing a $10,000 cap on the deductibility of state and local taxes, Congress has exceeded its powers under the Sixteenth Amendment."). This new argument fares no better than their original one. *See* U.S. Br. at 19-25. No such federalism principle has ever been recognized as a ground to invalidate a tax law. Furthermore, the federalism doctrine that was part of the debate surrounding the ratification of the Sixteenth Amendment was abandoned by the Supreme Court nearly eighty years ago.

The States do not identify any recognized constitutional federalism doctrine that requires an unlimited SALT deduction so as to "avoid undue interference with [their] ability to raise their own revenue from traditional sources." States Br. at 18. (Nor do they credibly explain why a capped SALT deduction unduly interferes with their ability to raise revenue from "traditional sources.") There is no constitutional rule that requires Congress and the states to tax only distinct assets or income, and specifically no constitutional reason why a given dollar of income cannot be taxed both by a state and by the federal government, without any offsetting deductions. The Constitution also does not require Congress to enact and maintain a tax deduction that benefits residents of certain states disproportionately. The States cite no constitutional provision giving rise to any relevant federalism principle, judicial opinions recognizing it, or historical materials supporting its existence. *See id.* at 16-18. Nor do any such materials exist.

As discussed in the Government's opening brief, Congress's constitutional taxing power is not limited in any way relevant to the SALT deduction. *See* U.S. Const. art. I, § 8; *id.* amend.

XVI; *see also* U.S. Br. at 20-21, 33-34. The States cite the history of federal taxation and the discussions surrounding the ratification of the Sixteenth Amendment to suggest the existence of a federalism-based limitation on Congress's taxation power. *See* States Br. at 16-21. However, Congress's historical practice with regard to the deduction of state and local taxes from federally taxable income actually demonstrates the absence of any applicable constitutional limitation. At nearly no point in the past century has there been an absolute, unconstrained federal SALT deduction; instead, this deduction has almost always been subject to various limitations, which have increased over time, either by narrowing the types of state taxes eligible for the deduction or by enacting provisions that restrict the deduction's value for many taxpayers (*i.e.*, the AMT and the Pease limitation). *See* U.S. Br. at 5-6.[8] And regardless of the contours of the SALT deduction over time, the Supreme Court has rejected the notion that Congress's historical practice with regard to the analogous state-bond tax exemption "manifest[ed] an intent to freeze [it] into the Constitution." *Baker*, 485 U.S. at 522 n.13.

[8] While the States surprisingly claim that the pre-2018 AMT and Pease limitation did not substantially limit the SALT deduction, *see* States Br. at 21 n.21, it is clear that they did do so. *See, e.g.*, Frank Sammartino, Tax Policy Center, *How Would Repeal of the State and Local Tax Deduction Affect Taxpayers Who Pay the AMT?* at 1-2 (June 15, 2017), https://www.taxpolicycenter.org/sites/default/files/publication/142256/2001309-how-would-repeal-of-the-state-and-local-tax-deduction-affect-taxpayers-who-pay-the-amt.pdf ("High-income households disproportionately benefit from the SALT deduction because they are more likely to itemize and pay more state and local taxes. . . . The AMT, however, limits or eliminates the benefit of the SALT deduction for many high-income taxpayers. . . . State and local taxes are not deductible under the AMT, and that is a major reason why taxpayers pay the alternative tax."); Jared Walczak, Tax Foundation, *How the State and Local Tax Deduction Interacts with the AMT and Pease Limitation* (Nov. 6, 2017), https://taxfoundation.org/state-and-local-tax-deduction-amt-pease/ ("The Pease limitation . . . reduces the value of a taxpayer's itemized deductions by 3 percent for every dollar of taxable income above a certain threshold . . . . This reduction continues until [it] has phased out 80 percent of the value of itemized deductions. . . . The Pease limitation, therefore, can have the effect of *limiting* the value of the state and local tax deduction.") (emphasis in the original). The argument that the 2017 Tax Act is different from these prior limitations for constitutional purposes because of the supposed intent of Congress is addressed *infra* in Point II.C.

As for the ratification of the Sixteenth Amendment, the historical materials the States cite include policy arguments for and against federal income taxation generally, but no recognition of any constitutional doctrine requiring an unlimited SALT deduction or forbidding "interference with the States' ability to raise their own revenue from traditional sources." States Br. at 18; *see also* U.S. Brief at 21-25. Indeed, the only constitutional doctrine cited by the participants in the ratification debate (at least in the materials cited by the States) was the doctrine of "intergovernmental tax immunity," which at the time precluded any state or federal tax on income derived from a contract with another sovereign, such as federal taxation of the interest from state-issued bonds. *See Baker*, 485 U.S. at 515-17 (discussing *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 585-86 (1895)). This doctrine, however, is irrelevant to the SALT deduction, and in any event, has been substantially narrowed by the Supreme Court in the century since the Sixteenth Amendment's ratification.

At the time, the Court had held that intergovernmental tax immunity precluded federal taxation of not only interest from state bonds, but also, for example, salaries of state employees, income from state leases, and earnings from sales to state agencies. *See Baker*, 485 U.S. at 517 (citing *Collector v. Day*, 78 U.S. 113 (1871), *Burnet v. Coronado Oil*, 285 U.S. 393 (1932), and *Indian Motocycle Co. v. United States*, 283 U.S. 570 (1931)). (Similar prohibitions applied in the other direction, with regard to state taxation of the proceeds of federal contracts and the like. *See id.*) "This general rule was based on the rationale that any tax on income a party received under a contract with the government was a tax on the contract and thus a tax 'on' the government because it burdened the government's power to enter into the contract." *Id.* at 518.

Some participants in the debates surrounding the ratification of the Sixteenth Amendment agreed with the contemporary intergovernmental tax immunity jurisprudence and even cited

particular Supreme Court decisions approvingly. Opponents of the Amendment were concerned that its ratification would undermine the Court's decisions in this regard. For example, New York Governor Charles Evan Hughes was concerned that the broad language of the Sixteenth Amendment might upset the Supreme Court decisions that had found income on state instrumentalities not to be federally taxable. *See, e.g.*, *Hughes Is Against Income Amendment*, N.Y. Times, Jan. 6, 1910, at 2, Conroy Decl. Ex. 15 (citing *Collector v. Day*, and *Pollock v. Farmers' Loan & Trust*). On the other hand, supporters of the Amendment who also agreed with the intergovernmental tax immunity jurisprudence, including Senator William Borah, argued that ratification would not affect it because the sole effect of the Amendment would be to eliminate the apportionment requirement for federal income taxation. *See* 45 Cong. Rec. 1694-96 (Feb. 10, 1910), Conroy Decl. Ex. 19; *see also* U.S. Br. at 23 n.6 (summarizing other sources).

Beginning in the late 1930's, the Supreme Court began dismantling its broad intergovernmental tax immunity jurisprudence, concluding that taxing income that a private party derives from a government contract was constitutionally distinct from taxing the government itself. *See Baker*, 485 U.S. at 520 (noting that "[t]he rationale underlying *Pollock* and the general immunity for government contract income has been thoroughly repudiated by modern intergovernmental immunity caselaw"). The Court held that Congress could tax state employees' salaries and income from state leases, and even upheld a state tax on a contractor whose cost was directly passed on to a federal agency as part of the contract. *See id.* at 521-22. By 1988, when it finally had the opportunity to consider, and uphold, federal taxation of the interest on state bonds (as Congress had only decided to tax state-issued bearer bonds in 1982), the Supreme Court reiterated that the expansive intergovernmental tax immunity doctrine was a thing of the past. *See id.* at 522-27. All that remains of the immunity doctrine now is the rule

that the federal and state governments cannot tax each other directly, but can each tax private parties with which the other sovereign does business, even if the ultimate financial burden falls on the other sovereign. *See id.* at 523 & n.14.

This doctrine has no relevance to the constitutionality of the SALT deduction, either now or a century ago. The States have not argued, nor could they, that a limitation on the deduction individual taxpayers can claim against their federal tax liabilities constitutes an impermissible tax on the states. And, again, they have failed to identify, or cite any authority recognizing, any other federalism principle of which the SALT deduction cap supposedly runs afoul. There is thus no federalism doctrine supporting the States' position.

### B. The SALT Deduction Cap Does Not Impermissibly Coerce the States into Altering Their Fiscal Policies

The States next argue that the 2017 Tax Act impermissibly coerces them into changing their fiscal policies, while acknowledging that any such coercion is indirect. *See* States Br. at 26-29. This argument rests on both a faulty basis of comparison for the Act and a misapprehension of the applicable legal principle.

The States' complaint—and their entire economic analysis of the impact of the 2017 Tax Act—improperly compares the current law (in which the SALT deduction is limited) to a scenario in which Congress enacted the Act exactly as it did, except left out the SALT deduction cap. *See* States Br. at 22-23; States 56.1 ¶¶ 50-54 (which, per States Br. at 23 n.25, calculates the "net increase in taxpayers' tax liability caused by the inclusion of the new cap on the SALT deduction in the 2017 Tax Act"); *see also* States Br. at 4 ("Taxpayers in the Plaintiff States must pay hundreds of billions of dollars in additional federal income taxes because of the cap on the SALT deduction, *relative to what they would have paid if the 2017 Tax Act had been enacted without the cap*." (emphasis added)). This comparison is at odds with the statute Congress

enacted. The SALT deduction cap is not a standalone feature of the 2017 Tax Act, but instead, as the States acknowledge, one of its core "revenue-generating" provisions that partially offset the cost of the statute's tax cuts.[9] Compl. ¶ 97; *see also* Joint Comm. on Taxation, *Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act"*, at 2 (Dec. 18, 2017), https://www.jct.gov/publications.html?func=startdown&id=5053 (Item D.1, estimating the amount of revenue expected to be generated by the repeal of certain deductions, principally the SALT deduction).[10]

Thus, the proper comparison (if there is one) is between the 2017 Tax Act as enacted and the state of the Internal Revenue Code beforehand, in which the SALT deduction was limited by a broader AMT and the Pease limitation, overall tax rates were higher in many brackets, and the standard deduction was lower. *See* U.S. Br. at 5-6. Using the appropriate benchmark, the overall federal tax burden on the States' residents is now lower than it was before the Act. *See* Inst. on Taxation and Econ. Policy, *The Final Trump-GOP Tax Bill: National & 50-State Analysis*, tbls.2-3 (Dec. 2017), https://itep.org/wp-content/uploads/Trump-GOP-Final-Bill-Report.pdf ("ITEP Report"); *cf.* States Br. at 9 n.10 (obliquely acknowledging this by noting that "certain" of their "residents will benefit from the 2017 Tax Act"). While some individual taxpayers in the

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[9] The States do not argue that the SALT deduction cap is severable from the rest of the 2017 Tax Act, particularly given its significant revenue-raising function. The Government does not concede the severability of the cap, but the issue need not be addressed in resolving the parties' present motions.

[10] Indeed, in order to enact the Act through the Senate's so-called "reconciliation" procedure, the statute could contribute no more than $1.5 trillion to the federal deficit over a decade. *See* H. Con. Res. 71, 115th Cong. (2017); 2 U.S.C. § 644(b)(1)(E). Without the hundreds of billions of dollars in revenue generated by capping the SALT (and other) deductions, the 2017 Tax Act would have exceeded this limitation. *See* Joint Comm. on Taxation, *supra*, at 8 (showing a net negative budgetary effect of the 2017 Tax Act totaling $1.456 trillion over a decade). Consequently, the Act could not have been passed without the SALT deduction limit absent other significant changes.

States will now pay more than they did previously, others will pay less, as would be expected from any significant change in tax policy, but the overall effect of the Act is to lower federal taxes, including for each plaintiff State's population as a whole. *See* ITEP Report, tbls.2-3. The States present no analysis of how this overall lower federal tax burden on their residents will affect economic activity and state tax revenues, presumably because the result does not support their argument here.

Even if the overall effect of the Act had been to raise federal taxes, however, this too would be a legitimate exercise of congressional power; there is no constitutional one-way ratchet requiring Congress only to decrease the federal tax burden, regardless of any secondary effects on states or their residents. There is thus no basis for the States' argument that the 2017 Tax Act, and in particular its SALT deduction cap, creates impermissible "economic coercion" to decrease state tax rates and reduce state-provided services by depriving them of revenue. *See* States Br. at 28.

In any event, any economic incentives in the Act are plainly "permissible persuasion" rather than "impermissible coercion." States Br. at 27 (quoting *NFIB*, 567 U.S. at 585) (brackets, quotation marks omitted). In *NFIB*, 567 U.S. at 585, the Supreme Court held that Congress could not condition states' receipt of hundreds of billions of dollars in existing Medicaid funds on their agreement to dramatically expand their Medicaid programs. The Affordable Care Act provided that states that did not agree to expand their programs—for which they would also have to commit billions of dollars of their own additional spending—would lose out not only on federal dollars allocated to the expansion, but their entire federal Medicaid allotment, potentially stripping millions of their residents of health insurance and depriving the states of more than 10% of their revenues. *See id.* ("Nothing in our opinion precludes Congress

from offering funds under the Affordable Care Act to expand the availability of health care, and requiring that States accepting such funds comply with the conditions on their use. What Congress is not free to do is to penalize States that choose not to participate in that new program by taking away their existing Medicaid funding."). This stark set of facts, the Court held, constituted coercion. *See id.*

On the other hand, the Supreme Court has held that Congress can permissibly withdraw tax breaks for state-issued bearer bonds while retaining the exemption for registered bonds, even if Congress's goal was to incentivize states to alter their bond-issuing practices. *See Baker*, 485 U.S. at 511, 513-15.[11] And, several decades ago—while the broad intergovernmental tax immunity doctrine was still alive and well—the Court upheld a federal estate tax that exempted income subject to state estate taxes, though the provision undoubtedly benefited states with estate taxes and incentivized others to enact such taxes. *See Florida v. Mellon*, 273 U.S. at 17. It is thus permissible for Congress to provide tax-based incentives for states to alter their taxing and revenue-raising practices, but it may not coerce states to participate in a federal program by threatening to take away substantial preexisting federal funds (such as Medicaid funding).

As discussed above, the overall effect of the 2017 Tax Act is to lower federal taxes on the States' residents even though the federal tax burden on a minority of those residents will increase

[11] The States incorrectly suggest that *Baker* is no longer good law, as it "was decided before the Supreme Court's more recent decisions," which supposedly "re-invigorat[ed] principles of federalism as a structural feature of the Constitution," States Br. at 25. However, the States fail to acknowledge that the Supreme Court cited *Baker* with approval in 2018 and distinguished it from cases in which the Court found that the government had impermissibly coerced states. *See Murphy v. Nat'l Collegiate Athletic Ass'n*, 138 S. Ct. 1461, 1478 (2018) (the tax provision in *Baker* was constitutional because it "did not order the States to enact or maintain any existing laws," but instead "had the indirect effect of pressuring States to increase the rate paid on their bearer bonds in order to make them competitive with other bonds paying taxable interest").

because of the SALT deduction limit. *See* ITEP Report, tbls.2-3. There is thus no basis for the States' claim of unconstitutional coercion.

**C. The SALT Deduction Cap Does Not Violate the States' Equal Sovereignty**

Finally, the SALT deduction cap does not violate the States' equal sovereignty by improperly targeting them for differentially adverse or coercive treatment. *Contra* States Br. at 29-36. The States concede that "the Constitution permits the burden of a federal tax to have differential effects on taxpayers in different States." *Id.* at 34; U.S. Br. at 33-34; *see also, e.g.*, *Fernandez v. Wiener*, 326 U.S. 340, 359 (1945) ("[A] taxing statute does not fall short of the prescribed uniformity because its operation and incidence may be affected by differences in state laws."). They claim, rather, that their sovereignty was violated because of public comments made by (and supposed underlying improper motives of) federal officials and political commentators about the cap or about SALT deductions in general. States Br. at 29-31. The States claim that their cherry-picked remarks—none of which was made within legislative proceedings leading to the enactment of the 2017 Tax Act—render the SALT cap unconstitutional. *Id.*

As explained in the Government's opening brief, comments like the ones collected by the States are irrelevant to the constitutionality of the SALT deduction cap. *See* U.S. Br. at 34-38. It is well-settled that when Congress exercises its taxing power, even if "the tax is burdensome or tends to restrict or suppress the thing taxed . . . it is not within the province of courts to inquire into the unexpressed purposes or motives which may have moved Congress to exercise a power constitutionally conferred upon it." *Fernandez*, 326 U.S. at 362; *see also J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 412 (1928) ("the existence of other motives in the selection of the subjects of taxes cannot invalidate congressional action"); *Sonzinsky v. United States*, 300

U.S. 506, 513-14 (1937). The States admit that the inclusion of the SALT deduction cap in the 2017 Tax Act had a legitimate purpose: to raise revenue to offset the effects of tax cuts in the Act. *See* Compl. ¶ 97; U.S. Br. at 7, 35. The States now argue that this concededly valid purpose should be ignored in light of a supposed hidden, nefarious motive exposed by extra-legislative comments. States Br. at 35 n.36. If the Court adopted this theory, then a handful of non-legislative comments made about any statute could render it unconstitutional, regardless of whatever legitimate purpose the provision otherwise serves. No precedent supports this extreme conclusion.[12]

Even if the Court considered the remarks gathered by the States, they are wholly unpersuasive of the supposed improper motive harbored by the Congress that enacted the 2017 Tax Act. The Government's opening brief addressed many of the quotations in the States' complaint. *See* U.S. Br. at 35-38. The States add a few more in their motion, States Br. at 29-31,[13] but these do not bolster their argument. As noted above, none of these quotations was drawn from any legislative proceeding relating to the enactment of the SALT deduction cap, but rather from media interviews and other non-government events. *See id.*[14]

[12] In addition, as also explained in the Government's opening brief, public officials' expression of their own views does not undercut the presumption that Congress acted in a proper and lawful manner, nor can comments made by individuals who are not part of the Congress that enacted the 2017 Tax Act be imputed to it. *See* U.S. Br. at 35-36.

[13] The States ignore the Government's explanation that their complaint seriously mischaracterized statements by Senator Rob Portman, *see* U.S. Br. at 36-37, and continue to misleadingly cite these remarks in their opposition brief, *see* States Br. at 30.

[14] Moreover, most of the cited comments pre-date the ultimate provision at issue, and refer instead to earlier versions of the legislation that would have more severely cut back the SALT deduction or eliminated it entirely. *See* H.R. 1, 115th Cong. (Nov. 2, 2017) (proposing the total elimination of deductions for state, local, and sales taxes paid, and capping property tax deductions); Sen. Amend. to H.R. 1, 115th Cong. (Nov. 16, 2017) (eliminating deductions for all state and local taxes, including property and state income taxes). The ultimate version of the SALT deduction cap was finalized on December 15, 2017, and passed a few days later. *See* Engrossed Amend. to H.R. 1, 115th Cong. (Dec. 20, 2017).

The States identify no case holding that comments about a statute made outside the legislative process (or indeed by non-legislators) are relevant to an analysis of the statute's constitutionality. *See* U.S. Br. at 35-36. The few authorities the States cite, *see* States Br. at 36 (citing *Johnson v. S. Pac. Co.*, 196 U.S. 1, 19-20 (1904), *United States v. Reitano*, 862 F.2d 982, 985 (2d Cir. 1988), and a law review article), concern the use of legislative history to interpret ambiguous statutory language, which is not the issue here. The States also cite *Shelby County*, 570 U.S. at 544, for the proposition that unequal targeting of states violates their equal sovereignty. States Br. at 29. That case is clearly inapposite, however, because the provision at issue there applied explicitly only to particular states, so there was no question that Congress deliberately intended to treat those states differently. *Shelby County*, 570 U.S. at 544. The SALT deduction cap, in contrast, applies by its terms uniformly to taxpayers residing in each state. The States further rely on *NFIB* to argue that a federal statute may be unconstitutional if it is motivated by congressional intent to unduly influence states. States Br. at 35; *NFIB*, 567 U.S. at 577. But in that case, as discussed above, Congress imposed a direct economic penalty expressly designed to coerce all states to participate in an expanded federal Medicaid program. 567 U.S. at 580-85. That is in sharp contrast to the SALT deduction cap, which does not coerce the States into any policy change or exert any comparable direct pressure on them.

Finally, much of the States' purported "evidence" of targeted, differential harm is questionable at best. They argue that the 2017 Tax Act was expressly "designed" to penalize their taxpayers while rewarding those in other states, *e.g.*, States Br. at 31, but marshal little support for this conclusory point. As noted above, many of the States' analyses compare what their taxpayers will pay in federal income taxes under the current law "relative to what they would have paid if the 2017 Tax Act had been enacted without the new cap," *id.* at 31 n.32, but

this is an inappropriate comparison, given that Congress never gave any consideration to such a law. This argument also disregards the Act's other provisions that will reduce many of their taxpayers' overall tax liabilities. *See* U.S. Br. at 6-7. Finally, much of the States' purported supporting economic analysis is poorly explained as to its methodology, and is at least partly based, on its face, on conjecture and speculation. *See, e.g.*, Declaration of Scott Palladino, ECF No. 1-2, ¶ 27 (concluding that more New York taxpayers will experience tax increases as a result of the Act and expressing, without citing specific data, a "belie[f] [that] this [effect] is due primarily to the SALT Deduction Cap"); *cf.* States Br. at 32 n.33 (the SALT cap "could result" in certain losses in home equity values, and "could" result in a corresponding decrease in economic activity). In sum, the States fall far short of demonstrating that the SALT deduction cap targeted them in any way, much less in a constitutionally impermissible manner.[15]

**CONCLUSION**

For the foregoing reasons and the reasons set forth in the Government's opening brief, the Court should dismiss the States' complaint and deny their cross-motion for summary judgment.

[15] The States also incorrectly claim that the Government has continued to specifically target them because the IRS proposed a regulation to clarify whether federal charitable contribution deductions are available when taxpayers receive or expect to receive corresponding state or local tax credits in exchange for those contributions. *See* States Br. at 33; U.S. Br. at 38 n.14. This proposed rulemaking is irrelevant for the reasons already set forth in the Government's opening brief. *See* U.S. Br. at 38 n.14. In any event, even if the proposed rulemaking were somehow relevant to the constitutionality of the already-enacted SALT deduction cap, the rulemaking is itself also neutrally applicable and would naturally apply to—not target—taxpayers in any states and localities who receive tax credits in exchange for contributions. *Id.*

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Respectfully submitted,

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